UNIT 9: ECONOMY OF INDIAN SOCIETY

UNIT STRUCTURE

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9.1 LEARNING OBJECTIVES

After going through this unit, you will able to -

- understand about various forms of economies
- discuss about the Indian Economic system
- Know about New Economic Policies - Liberalization, Globalization and Privatization concepts.

9.2 INTRODUCTION

When we observe the world around us on a daily basis, we can see that there is always some kind of transaction going on. For example, if you visit a market place, you will witness goods being bought by seller and

people buying it in exchange for money. This kind of transaction has been going on since the beginning, when humans beings started forming societies and travelling from one place to another in search of food, water and suitable place for living. This gave birth to the first form of economic formation. To understand the nature of economy of Indian Society, we will discuse in this unit the different types of economy and its characteristies, economy in the pre-independence and Post-independence period and the new economic policies of India.

9.3. ECONOMY AND ITS TYPES

In formal terms, an economy is a system of organization and institutions that either facilitates or play a role in the production and distribution of goods and services in a society. There are primarily four types of economic systems in the world. They are (i) Traditional Economic System; (ii) Command Economic System; (iii) Market Economic System and (iv) Mixed Economic System.

Let us now study in brief all the four forms of economies.

9.3.1 Traditional Economy

A traditional economy is a system which relies on customs, history and time honored beliefs. The economic decisions for production and distribution are based on traditions. Some of the main characteristics under traditional economy are as follows:

- Traditional economy is centered around family and tribes. Elder's experiences are taken as means of guide to day-to-day activity and economic decisions.
- This economy existed in hunter-gatherer and nomadic societies.
- Most traditional economies produced only what they needed, so surplus was rarely there.
- In traditional economies, trading was done among different groups and they rely on barter where competition rarely existed. Rather than competition it was a system that complemented each others trade. For example, a tribe who hunts will exchange food with the tribe that does fishing.

- The traditional economies started to evolve once nomads started settling down and farming was taken as a major activity. To utilize the surplus produce they started to facilitate trading which led to creation of money.

9.3.2 Command Economy

Over the years as the society evolved and led to formation of state and nation state which were controlled by a government (monarchy or empire) the economy also started to evolve. When government was formed all economic decisions were taken by the central government. In formal terms, the economy where all economic decisions were taken by the central government is called command economy.

Within Command economy, the government owns land and the means of production. This kind of economy developed in countries where government owns very large amount of valuable resources and regulates its resources. For example: In the current scenario, China still follows this form of economy. India used to follow the command economic system till 1991 until New Economic liberalization came into being. Some of the major characteristics under command Economy are as follows:

- The government creates a central economic plan. They create time bound plans i.e. five-year plan for every sector and region of the country.
- The government allocates all resources according to central plan. It tries to use the nation's capital, labour and natural resources in the most efficient way possible.
- The central plan sets the priorities for the production of all goods and services that includes quotas and price controls.
- Under this economy major focus is placed on defence sector development.
- The government creates laws, regulations and directives to enforce the central plan.

9.3.3 Market Economy

Market economy can also be called as free enterprise economy. Market economy is driven by consumers need and demand, solely based on interaction between individuals and businesses. This form of economy can be witnessed in developed countries of the world especially in the United States of America. Some the main characteristics under market economy are stated below :

- Within market economy most of the goods and services are privately-owned. The owners can make legally-binding contracts to buy, sell or lease their property.
- Owners have freedom to produce, sell and purchase goods and services in a competitive market.
- The producer can sell their product to highest bidder even while negotiating lowest price for their product.
- The force of competition keeps prices low and ensures that society gets goods and services at desirable rates.
- The economy relies on an efficient market to sell their goods and service. The economy makes sure that all buyers and sellers have access to same information.

9.3.4 Mixed Economy

Mixed economy is a combination of market, command and traditional economies because it protects private property and allows free market and the laws of supply and demand to determine market prices. At the same time the government safeguards its people and market. Mixed Economy is also known as Dual Economy. Some of the unique characteristics of mixed economy are stated below:

- Within mixed economy both public and private sectors function. The private sector motive will be profit making and the public sector will focus on both profit motive and promotion of social welfare.
- Both the government and private enterprises work jointly.
- Under mixed economy, government exercises strict control and regulation over private sector enterprises and industries.

- Mixed Economy is also known as planned economy because the whole economy is subject to the planning of the government.
- Government takes additional steps to provide social security and takes steps to reduce inequalities of income and wealth.

India follows mixed economy and to understand how the whole economic structure of India has evolved over times let us go back in time to understand it. Let us divide the following discussion in two parts

- Indian Economy before Independence and
- Indian Economy in the Post Independence Period

9.4 INDIAN ECONOMY BEFORE INDEPENDENCE

Before the British came to India, the nation was a prosperous one. The village communities were self-sustained. India exported Cotton, Silk and Wooden fabrics, Artistic wares, spices, Opium and Indigo to name a few. In the 17th and 18th centuries Europe was a major customer of Indian's manufacturing goods. India was rarely an importer from other nations, infact the villages of India were self-sufficient and had to rarely venture out of village in search of goods or opportunities. The occupations carried on by village communities were hereditary and passed from one generation to the next. In a way village formed a network of interdependence within the communities.

Since India was a rich country with natural resources and industries, she was conquered over centuries by various nations. India was conquered by Mughals, Dutch, Portuguese and British. The only difference between British conquest and the others was that the British conquest had led to emergence of a new political and economic system whose sole aim was the exploitation of India's natural resources to fulfill their own interest.

Before the beginning of Industrial Revolution in England the East India Company concentrated on exporting Indian manufactured goods, textiles, spices etc to other European nations where Indian goods were in high demands. The Industrial Revolution changed the whole dynamics of Indian trade. As industries were being created in England, demand for raw

materials increased for British industries. They made severe attempts to restrict and crush Indian manufacturers. Emphasis was given to promote commercial agriculture in India to meet the demands for raw materials for England. This made the Indian traditional handicraft industry suffer. The unemployment of artisans and craftsmen's were increasing in large numbers. They were shifting to agriculture which resulted in increased dependence on land. The increasing pressure of population on land was responsible for progressive sub-division and fragmentation of land holdings. As the land holding reduced, tenants started increasing the rent of land holdings which in return increased the number of landless labourers because they could not effort to pay high rents.

To bring stability in agriculture the British introduced land settlement in 1793. In Bengal and in few Eastern parts **'permanent settlement'** was introduced. Under this settlement, the landlords were recognized as the full proprietors of the land. In return of the honour, the landlords were entrusted to collect rent from the farmers for the use of land. Another different form of land system was evolving in the western part of the country. It was the **'Ryotwari System'**. Under this system, each peasant was responsible for paying the land revenue to the government. The peasant holding the land was recognized as landlord and had full rights on land regarding sale, transfer, sub-let or lease as long as he paid land revenue to the government. Even though both the systems were different their ultimate objective was collection of taxes. Daniel and Alice Thorner write, "Whereas the zamindari system made the landlords masters of the village communities, the ryotwari system cut through the heart of the village communities by making separate arrangements between each peasant cultivator and the state".

The revenues collected from India were never utilized within the economy which would benefit the Indians rather it was diverted to set up industrial concerns of British nationals in India. The then British government protected their interests making them the monopoly of trade and industries. Further Indian wealth was drained out of India in the form of remittances of profits and interest. This continued since the inception of the British rule to 1947 when India became Independent.

9.5 INDIAN ECONOMY IN THE POST INDEPENDENCE PERIOD

At the time of independence India was a country with shattered economy widespread illiteracy and poverty. The entire economic structure had to be reconstructed for genuine development of the country. The post Independence economy can be divided into three phases. The first phase was from Independence to 1990's; Second phase started with the introduction of New Economic Policy and currently we are in the third phase where existing measures are scaled up and new delivery mechanism are being created.

- **First Phase:**

After Independence, the policymakers in India launched the project of economic development with a heavy involvement of the state and a democratic polity. The economic development in India followed socialist-inspired policies. This included state-ownership of many sectors. As a result, in the first three decades after independence, India's per capita income increased at a rate of around 2.5 % annualy. This modest economic success led to the foundation of a complex industrial economy and fairly reasonable rate of agricultural growth, with subsidized irrigation and chemical fertilizers.

- **Second Phase:**

The political elite in India launched a process of economic reform with the launching of a policy of liberalization and privatization since the1990s. This was launched with a view to unleashing the entrepreneurial forces from the shackles of controls and regulations that would ensure economic growth.

The major elements of changes in policy were the de-licensing and deregulation of investment and production, discontinuation of exclusive reservation of many key industries, gradual abolition of quantitative restrictions on imports, movement towards a market-determined exchange rate, reduction of average levels of direct and indirect taxes and some streamlining and rationalization of the tax structure etc.

The flexible industrial licensing policy and a relaxed FDI policy started getting positive responses from international investors. Among the major

factors that drove India's economic growth following the economic reforms were increased FDI, adoption of information technology and an increased domestic consumption.

- **Third Phase:**

The economic transformation of the country continues to push forward with third generation reforms. Third generation reforms deal with administrative and judicial reforms, labour market and FDI reforms. The center and state governments are working closely to make further progress. In this phase reform is taken with bottom-up approach and not the trickle-down approach that was pursued in the first and second phases of reforms. The emphasis is put on Panchayati Raj that is made to play an interventionist kind of role to bring the fruits of growth to the door steps of the common man. The introduction of the Kisan Credit Card, micro-credit and encouragement of the Self Help Group movement has shown good results. Moving further, cottage industry, small entrepreneurs, artisans, etc., are encouraged for skill development. They are being financially educated to develop the banking habit. Greater employment opportunities are created through institutional mechanism.

9.6 NEW ECONOMIC POLICIES

As we have seen in the second phase talks about the introduction of New Economic Policies which redefined the Indian economic system post 1990 makes it important to understand it in details. The discussion below aims for that.

9.6.1. Liberalisation

Economic Liberalisation increased the responsibility and role of private sector and at the same time reduced the control of the government on economic affairs with the hope of creating an environment for rapid economic development.

The long term reforms that were brought with the introduction of Liberalisation are as follows:

- **Deregulation of Industrial Sector:** Industrial licensing was introduced under which entrepreneurs had the permission from

government to start a firm, decide of mode of operation and its production.

- **Financial Sector Reforms:** You will be aware that the financial sector of India is regulated by the Reserve Bank of India (RBI) and it decides and controls the money flow into the economy. This policy reduced the role of RBI and allowed financial sector to take decisions on their own without consulting the RBI. This led to the establishment of private sector banking of both Indian and foreign origins.
- **Tax Reform:** Direct taxes such as corporation tax, which was higher earlier were gradually reduced. Tax systems were simplified and rates lowered substantially for taxpayers.
- **Foreign Exchange Reforms:** The Indian currency was devalued against foreign currencies which led to inflow of foreign exchange.
- **Trade and Investment Policy Reforms:** The aim was to develop local industries and increase use of modern technologies. Imports were kept check by putting quantitative restrictions and export duties removed to increase the competitive position of India in International market.

9.6.1.1 Liberalisation in India

During the 1980's the expenditure of the Indian government gradually increased more than the income generated because the economy was inefficiently managed. As the expenditure of the government began to exceed its revenues by larger margins over the years, the government started to borrow money from banks, people within the country and from International Financial institutions to pay import bills like petroleum. The borrowings after a point became unsustainable leading to rise in the price of essential goods within the country. Towards the later half of 1980's the difference between import and export grew so high that the country did not have sufficient foreign exchange to pay international lenders.

To overcome the financial crisis India approached the World Bank and International Monetary Fund (IMF) and received a loan of

7 billion US dollars. The loan was based on the condition that India will open her economy and liberalize restrictions on the private sector and remove trade restrictions for other countries of the world. India agreed to the conditions of World Bank and IMF and announced the New Economic Policy (NEP). The main objective of the Policy was to create a more competitive environment in the economy and removing the barriers for private firms.

The New Economic Policy was categorized into two parts: namely i) Stabilization measures which were short term measures to maintain sufficient foreign exchange reserve and price rise under control and ii) Structural Reforms which were long term measures to revive the Indian economy. These measures can be categorized as Liberalization, Privatization and Globalization.

9.6.2 Globalization

In simple terms, Globalization is the free movement of goods, services and people across the world in a seamless and integrated manner.

According to IMF, "The growing economic inter-dependence of countries worldwide through increasing volume and variety of cross border transaction in goods and services and of international capital cash flows, and through the more rapid and widespread diffusion of technology".

Although globalization means integration of the economies of the nations but its real aim is to build greater interdependence and integration. The interdependence and integration leads to creation of networks and activities transcending economic, social and geographical boundaries.

- **Major Milestone of Globalization:**
  - **Outsourcing:** One of the important outcomes of globalization is Outsourcing. Outsourcing means hiring of services like legal advice, computer service, tele-marketing, advertisement, security etc. by companies in developed countries from developing countries where

the cost of expenditure for hiring people is lower. One of the most common example is voice-based business processes popularly known as BPO or call centres in India.

- **Business Expansion:** Due to globalization many Indian companies have expanded their wings to other countries. For example: ONGC Videsh offices are currently located in 17 countries namely, Vietnam, Russia, Colombia, Venezuela, New Zealand to name a few. Tata Steels have their operations in 26 countries which in return have generated huge foreign return to the economy.

9.6.3 Privatization

Privatization refers to induction of private sector participation in the management and ownership of Public Sector Enterprises. It is the process of transferring ownership of business, enterprise, agency, public property and service from the public sector to the private.

In India the public sector was affected by inefficiencies and incompetence in the 1980s. The New Economic Policies that were introduced in 1991 led to the initiation of several reform measures and one of them was selling of loss making industrial units to private sectors to revive the loss making industries. Some of the advantages and disadvantages of privatization are stated below:

➢ **Major advantages of Privatization:**

- **Lack of Political Interference**: A state enterprise may employ surplus workers who are inefficient and never removed because of negative publicity. Such situation does not happen in private sector as they look for efficient workers and do not hesitate to let go inefficient employees.
- **Improved efficiency**: The main motive of private companies is to make profit. Such companies provide various target incentives to boost its employee's effort which increase the overall output of the company.

- **Shareholders:** Private firms always have the pressure from shareholders to perform efficiently as there is always the fear of the firm being taken over due to inefficient functioning.
- **Increased Competition:** When state owned monopolies are privatized and de-regulation happens, policies allow more firms to enter the industry and increase the competitiveness of the market. This increases competition within private firms and becomes a scope for improvement and efficiency.

➢ **Major Disadvantages of Privatization:**

- Private companies' main motive is to earn profit, which is in contrast with government companies which focus on social capital. If privatization happens it will result in lesser funds for society because they do not have obligations to contribute back to society.
- Privatization affects the employees because in private sector enterprises there is emphasis on performance which indirectly results in work pressure and meeting deadlines and targets. Individuals who were working in public undertaking for years without much pressure find it difficult to adjust to new setting under private enterprises.
- Privatization creates private monopolies which can abuse its monopolistic power. Therefore, government regulation is needed to keep in checks and balances.



CHECK YOUR PROGRESS:

Q1 : What are the major types of economic systems of the world?

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Q2 : What was the main objective of East India Company before the beginning of the Industrial Revolution?

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Q3 : Which was the first policy that Nehru introduced after becoming Prime Minister of Independent India?

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Q4 : When did Liberalization start in India?

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Q5. Give example of Globalization.

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9.7 LET US SUM UP

- An economy is a system of organizations and institutions that either facilitatesor plays a role in the production and distribution of goods and services in a society.

  There are primarily four types of economic systems in the world. They are (i) Traditional Economic System; (ii) Command Economic System; (iii) Market Economic System and (iv) Mixed Economic System.
- A traditional economy is a system which relies on customs, history and time honored beliefs.
- The economy where all economic decisions are taken by the central government is called command economy.
- Market economy is driven by consumers' need and demand solely based on interaction between individuals and businesses.
- Mixed economy is a combination of market, command and traditional economies because it protects private property and at the same time allows free market and the laws of supply and demand to determine market prices.
- Before the British came to India, India was major exporter of Cotton, Silk fabrics, Artisanal and craft based wares, spices, Opium and Indigo.

- The Industrial Revolution changed the whole dynamism of Indian trade.
- Emphasis was made to promote commercial agriculture in India to meet the demands for raw materials in England. This made the Indian traditional handicraft industry to suffer.
- To bring stability in agriculture the British introduced land settlement in 1793 and also Introduced Zamindari and Ryotwari systems.
- The economy post Independent India can be divided into three phase. The first phase was from Independence to 1990's; Second phase started with the introduction of New Economic Policy and currently we are in the third phase where existing measures are scaled up and new delivery mechanism are being created.
- First phase followed socialist-inspired policies that included state-ownership of many sectors.
- Second phase was the launch of New Economic Policy of Liberalization and Privatization.
- Third phase is taken with bottom-up approach with focus on Panchayati Raj.
- Liberalization unleashed the entrepreneurial forces from the shackles of controls and regulations that would ensure economic growth.
- Globalization is the free movement of goods, services and people across the world in a seamless and integrated manner.
- Privatization is the induction of private sector participation in the management and ownership of Public Sector Enterprises.



9.8 FURTHER READINGS

1) Datt & Sundharam, (2008) "Indian Economy"; S. Chand & Company Pvt. Ltd., New Delhi.

2) Rao, C. N. Shankar, (2008) " Sociology, Principles of Sociology with an Introduction to Social Thought"; S. Chand & Company Pvt. Ltd., New Delhi.